Update on the Global Crisis: The Worst is Over, LAC Poised to Recover

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The World Bank
Structure of Presentation

- The worst seems over, but fragilities remain
  - The nature of the incipient recovery

- How has LAC fared in comparative terms?
  - Recession in LAC and elsewhere
  - Growth collapse in LAC and elsewhere
  - Explaining the differences in growth collapse

- Looking ahead: much haziness in the horizon
  - Short-run recovery
  - Medium-term growth and rebalancing uncertainty
The Worst Seems Over But Fragilities Remain

Part 1
The catastrophic scenario was averted…

Standard & Poor's (Financial and Total Indexes) and VIX

Index number Aug-15-2007 = 100 (S&P indexes)

Source: Bloomberg
... thanks to bold risk absorption and countercyclical actions by central banks, led by the U.S. Fed ...
... and to substantial injections of fiscal and credit stimuli, including in China

China: Real Private Domestic Credit
Annual Variation

Source: IFS
The large emerging economies, including Brazil, are leading the world’s recovery.

- The emerging economies with strongest recoveries include Brazil, China, India, Korea, Malaysia, Philippines and Thailand.
- They represent 52% of emerging economies’ GDP.
- Industrial production for this group increased by 18% from January to June 2009.

Source: CPB (Netherlands Bureau for Economic Policy Analysis)
With surprises on the upside, growth forecasts for the center and the periphery are being revised upwards ...

However, the process of economic repair in rich countries is still incomplete ...

**Developed Economies: Manufacturing PMI**

*Seasonally Adjusted*

- **PMI**: Manufacturing Purchasing Managers Index: assess business conditions in the manufacturing sector. A number above 50 indicates an expected increase of business conditions (expansion). A number below 50 indicates deterioration. Source: Bloomberg
... as the stimuli is most of the story so far behind the incipient recovery, especially in the US...

**Budget Balance of Central Government**
Accumulated in 12 Months

- Avg. in 2007: 1.3% of GDP
- 7.5% of GDP

**Gross Nominal Public Debt**
Annual Variation

- 82% of GDP
- 67% of GDP

**Manufacturers’ New Orders**
US$ Billion, Seasonally Adjusted

- Nondefense exc. Aircraft (rhs)

**Exports of Goods and Services, BOP Basis**
Seasonally Adjusted

**Source:** Federal Reserve Bank St. Louis and Economist Intelligence Unit (EIU)
... and fragilities remain in labor markets and in private demand...

Source: Bloomberg and Federal Reserve Bank St. Louis
Also, domestic credit to households and firms remains sluggish.

**Source:** Federal Reserve Bank St. Louis
External financial conditions have improved significantly for LAC and other emerging regions.
And the rebound in commodity prices benefit net exporting countries in the region

Commodity Prices

Oil WTI in Current US$, Wheat, Copper and Soybean: Index 01-Jan-05=100

- About 95% of LAC’s GDP and 90% of LAC’s population reside in countries that are net commodity exporters.
- About half the number of countries in LAC are net commodity importers and are mainly located in Central America and the Caribbean.

Source: Bloomberg
There is considerable heterogeneity in the pace of recovery across LAC countries.

Rebounding

Argentina
Brazil
Chile

Still Falling

Venezuela (rhs)
Peru

Stabilized?

Colombia
Ecuador
Mexico
Uruguay (rhs)

Source: Economist Intelligence Unit (EIU), GEM and IFS
How Has LAC Fared in Comparative Terms?

Part 2
2009 will be a year of recession for LAC (Mexico the hardest hit) but a broad recovery is expected for 2010.

Weighted average calculated based on 2007 nominal GDP. Source: Consensus Forecast (Sep. 2009), World Bank and IMF.
The 2009 recession in LAC is less pronounced than in other areas of the world

Recent Real GDP Growth and Forecasts for 2009-2010

Annual GDP Real Growth Rate,

Source: Consensus Forecasts (Sep. 2009)
But the recession in LAC threatens social gains

Between 2002 and 2008, almost 60 million people in LAC moved out of poverty.

Poverty for LAC is measured at PPP-adjusted US$4 a day. Source: Based on Azevedo, Molina, Rubiano, and Saavedra (2009).
The *growth collapse* in LAC is significant on average, although cross-country variation is non-trivial.
For many LAC countries, the collapse was from relatively high growth rates.

**Real GDP Growth in LAC**

*2007 and 2009 Forecasts*

*Source: Consensus Forecast (Sep. 2009), World Bank and IMF*
LAC’s growth collapse is similar to China’s and smaller to that of the Tigers and Eastern Europe.

### Growth Collapses Across the World


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<tr>
<th>Region</th>
<th>2007</th>
<th>2009</th>
<th>Change</th>
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<td>LAC</td>
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Source: World Bank, Consensus Forecasts (Sep. 2009) and IMF with LCRCE Staff calculations.
Explaining cross-country differences in the collapse

- **Regression analysis of the growth collapse from 2007 to 2009**
  - Sample of 126 countries

- **Collapses were larger in countries characterized by**
  - Greater trade and financial openness
  - Higher share of manufacturing exports
  - Greater export reliance on rich country markets
  - Weaker banking systems

- **This helps explain contrasts in the collapse**
  - Brazil-Mexico; LAC-Eastern Europe; LAC-East Asian Tigers

- **Soundness of macro policies played a positive role**
  - Dampening the collapse somewhat
  - Enabling countercyclical policies, particularly in the monetary front
  - Helping avoid systemic damage
Trade openness across emerging regions

Structure of GDP

*as% of GDP*

- **Exports**
- **Imports**
- **Private Consumption**

Regional aggregates are calculated as simple averages. Source: LCRCE Staff calculations based on EIU
The fall in foreign debt flows stands in sharp contrast with the stability of equity flows.

Net private flows for the world; Gross total flows for LAC-7 countries. Equity flows include FDI and portfolio equity flows. Source: Institute of International Finance (IIF)
Healthy banking systems dampened the collapse

Deposit to Loan Ratios
Emerging Countries, 2007 Data

Emerging countries were defined as lower middle income and upper middle income, World Bank Classification. Source: Beck, Demirgüç-Kunt and Levine (2009): Financial Structure Database
The dog that did not bark: absence of domestic crises in a region traditionally plagued by them

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<td>Argentina</td>
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The table shows the start year of banking crises. Source: Laeven and Valencia (2008) and Reinhart and Rogoff (2008)
Inflation-targeting countries in LAC undertook aggressive countercyclical monetary policies

**Monetary Policy Rates**

*Inflation-Targeting LAC Countries, in %*

- Brazil
- Colombia
- Chile
- Mexico
- Peru
- US

Source: Bloomberg
Looking Ahead: Much Haziness in the Horizon

Part 3
By and large, LAC is well-positioned for recovery

- Despite being financially globalized, LAC is coming out of the crisis without systemic damage
  - Improved macro-financial immune system passed a tough test
  - In contrast with rich countries, LAC’s fiscal and debt positions remain comfortable
  - Exchange rate flexibility acted as cushion (countercyclicality) and facilitated external adjustment at lower output cost than otherwise
  - LAC economies that are complementary to China’s lead the recovery

- Thus, LAC emerging as an attractive destination for investment
- But LAC will need to intensify its productivity-oriented agenda to seize opportunities going forward
  - Keeping the course of improvement in social and macrofinancial policy
Unlike rich countries, LAC comes out of the crisis with comfortable fiscal & public debt positions.

Source: Economist Intelligence Unit (EIU) and Consensus Forecast (Sep. 2009)
LAC economies that are complementary to China’s are recovering first.
LAC prospects depend on world growth, where much haziness exist beyond the short run

- In the short run, the global recovery is looking a lot like a V...
- ...but economic repair is still incomplete and fragilities remain
  - Will private sector demand be strong when stimulus fizzles away?
  - Will exit from stimulus policies be well-timed and orderly?
    - Premature retreat can kill the recovery; delayed retreat can rise inflation specter

- Medium-term growth for the world might be subdued
  - Financial system still impaired
  - Scenario of slow expansion of world trade in the context of rebalancing
  - Possible adverse impact on MT investment of regulatory uncertainty

- LAC can grow robustly while contributing to global rebalancing
  - LAC economy is the size of China’s but consumption has greater weight and investment has significant room to expand
World trade volume unlikely to grow fast for a while in a context of global rebalancing

Source: CPB (Netherlands Bureau for Economic Policy Analysis)
At the margin, LAC can contribute to global rebalancing more than China...

Output and Demand: China vs. LAC
GDP and Demand Components, 2007

Source: World Bank's WDI
... while raising savings and investment rates to underpin a higher growth path

Source: World Bank’s WDI and EIU. East Asian Tigers include the following countries: Hong Kong, Indonesia, Korea, Malaysia, Singapore, Taiwan, and Thailand.
Thank you